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# NOTES AND COMMENTS

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## BANKRUPTCY

### THE RIGHT OF THE MORTGAGOR TO AN APPRAISAL AND THE RIGHT OF THE MORTGAGEE TO A PUBLIC SALE UNDER SEC. 75 (s) (3) OF THE BANKRUPTCY ACT.

The petitioning farmer filed a petition under sec. 75 of the Bankruptcy Act and later, on Oct. 11, 1935, amended it, asking to be adjudged a bankrupt as provided for in sec. 75(s).<sup>1</sup> On July 22, 1938, respondent filed a petition in accordance with sec. 75(s)(3)<sup>2</sup> praying for an immediate sale and alleging that the debtor's financial condition was beyond reasonable hope of rehabilitation and that he had failed to comply with an order of the court. On Oct. 5, 1938, the debtor filed a cross-petition under sec. 75(s)(3) to have the land appraised or its value fixed by the court, to be allowed to redeem at that value, and to be discharged from liability on account of the deficiency. Respondent answered alleging that by the terms of sec. 75(s)(3) its request for sale took precedence over the debtor's right of appraisal. These contentions framed the issue in the principal case as to whether the debtor, under sec. 75(s)(3) must be accorded an opportunity, on his request, to redeem the property at the reappraised value or at a value fixed by the court before the court might order a public sale.

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<sup>1</sup> 11 U.S.C.A. sec. 203.

<sup>2</sup> 11 U.S.C.A. 203(s), sec. 75(s) (3) of the Bankruptcy Act reads as follows: "At the end of three years, or prior thereto, the debtor may pay into court the amount or the appraisal of the property of which he retains possession, including the amount of encumbrances on his exemptions, up to the amount of the appraisal, less the amount paid on principal: *Provided*, That upon request of any secured or unsecured creditor, or upon request of the debtor, the court shall cause a reappraisal of the debtor's property, or in its discretion set a date for hearing, and after such hearing, fix the value of the property, in accordance with the evidence submitted, and the debtor shall then pay the value so arrived at into court, less payments made on the principal, for distribution to all secured and unsecured creditors, as their interests may appear, and thereupon the court shall, by an order, turn over full possession and title of said property, free and clear of encumbrances to the debtor: *Provided*, That upon request in writing by any secured creditor or creditors, the court shall order the property upon which such secured creditors have a lien to be sold at public auction. The debtor shall have ninety days to redeem any property sold at such sale, by paying the amount for which any such property was sold, together with 5 per centum per annum interest, into court, and he may apply for his discharge, as provided for by this Act. If, however, the debtor at any time fails to comply with the provisions of this section, or with any orders of the court made pursuant to this section, or is unable to refinance himself within three years, the court may order the appointment of a trustee, and order the property sold or otherwise disposed of as provided for in this Act."

At the hearing the court found that there was no reasonable expectation that the debtor could refinance himself and that he had disobeyed the orders of the court and accordingly ordered that the property be sold at public auction. The order was affirmed on appeal.<sup>3</sup> The Supreme Court granted *certiorari* and speaking through Justice Douglas held the debtor's right to an appraisal superior to the creditor's right of sale. This result was reached by reconciling the two apparently inconsistent remedies in the statute<sup>4</sup> in the light of the purpose of the Act—farmer rehabilitation—thus giving the farmer the benefit of the doubt so long as the secured creditor's constitutional right of an interest to the extent of the value of the property was not impaired. The mortgagee's right of sale under this statute was interpreted to mean that this right was available provided the mortgagor did not choose to take advantage of the appraisal provision. The Court further held that, even if there were no hope for rehabilitation, and if the debtor had not complied with the Act or had disregarded court orders, the court could not absolutely order a public sale, but that the mortgagor must first be given an opportunity to take advantage of the appraisal provision.<sup>5</sup>

A short history of sec. 75(s) is essential here to an understanding of the problem. The principal case involves the constitutionality of a section of what is popularly known as the Frazier-Lemke Act<sup>6</sup> providing for farm moratoriums. The first Frazier-Lemke Act<sup>7</sup> was held unconstitutional in the *Radford* case<sup>8</sup> solely on the ground that it violated the Fifth Amendment to the Constitution. The *Radford* case enumerated five substantive right in specific property which had been taken.<sup>9</sup> It was not held that the deprivation of any one of these rights would have made the Act invalid, but that the cumulative effect of the statute was to deprive the mortgagee of his property without due process of

<sup>3</sup> *In re Wright*, 108 F. (2d) 361, 41 Am. Bankr. Rep. (N.S.) 797 (1939).

<sup>4</sup> Note 2, *supra*.

<sup>5</sup> *Wright v. Union Central Life Ins. Co., et al.*, 61 Sup. Ct. 196, 85 L.Ed. 166 (1940).

<sup>6</sup> Note 1, *supra*.

<sup>7</sup> Act of March 3, 1933, 11 U.S.C.A. sec. 203.

<sup>8</sup> *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 55 Sup. Ct. 854, 79 L.Ed. 1593, 97 A.L.R. 1106 (1934).

<sup>9</sup> "(1) The right to retain the lien until the indebtedness was paid. (2) The right to realize upon the security by a judicial sale. (3) The right to determine when such sale shall be held, subject only to the discretion of the Court. (4) The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself. (5) The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt."

law.<sup>10</sup> The second Frazier-Lemke Act<sup>11</sup> was passed in an attempt to eliminate the unconstitutional elements enumerated by the *Radford* case. It was held constitutional in the case of *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke*<sup>12</sup> on the ground that the five rights—including the right of sale—enumerated in the *Radford* case had been sufficiently preserved.

The principal case involves one of these rights—sale by the mortgagee. The problem to be discussed here is the extent to which this right has been altered by the principal case, and what relation the instant case bears to the *Radford* and *Vinton* cases.

Logically, the statute would seem to make the right of sale mandatory and unqualified for it seems to state a general rule—that the farmer shall have the property at the appraised value—with an exception concerning reappraisal and with the further exception to this exception that the mortgagee shall have a sale upon his request. The absence of mention by Justice Brandies in the *Vinton* case of any qualification of an absolute right would seem to indicate that he placed a similar interpretation upon it. This interpretation is sustained by reference to the history of the statute during enactment by Congress. As introduced, the bill contained no sale provision.<sup>13</sup> To remove a doubt of constitutionality, the Judiciary Committee, to which it was referred, added a provision “. . . That upon request in writing by any secured creditor or creditors, the court in its discretion, if it deems it for the best interests of the secured creditors and debtor, may order the property upon which such secured creditors have a lien, to be sold at public auction; . . .”<sup>14</sup> Later, the clause which made the right of sale discretionary was deleted so as to make the Act read as it does at present. The purpose of this change, as revealed by the debate on the bill, was to give “the creditor the right, as a matter of right, to have a foreclosure of the property in the event his debt had not been paid in full.”<sup>15</sup> This legislative intent is further shown by the deletion from the bill as originally reported from the Judiciary Committee of a clause limiting the right of the mortgagee to bid at the sale to not more than the appraisal price or the original amount of the loan, whichever was higher. This change was made to avoid unconstitutionality.<sup>16</sup> From

<sup>10</sup> See *Hanover National Bank v. Myses*, 186 U.S. 181, 190, 22 Eup. Ct. 857, 861, 46 L. Ed. 1113, (1120) (1902).

<sup>11</sup> Note 1, *supra*.

<sup>12</sup> *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, Va., et al.*, 300 U.S. 440, 57 Sup. Ct. 556, 81 L.Ed. 736, 112 A.L.R. 1455 (1937).

<sup>13</sup> S 3002, 74th Cong., 1st Sess.

<sup>14</sup> S 3002, as reported, sec. 6, p. 9; see Sen. Rep. No. 985, 74th Cong., 1st Sess. p. 4.

<sup>15</sup> 79 Cong. Rec. 14332, 14333.

these facts it can be concluded that although the desire and better judgment of Congress were probably otherwise, the statute was intended to give an absolute right of sale (including an unqualified right to bid at such sale) to the mortgagee and that this is the constitutional right which Justice Brandies had in mind in the *Vinton* case.

However, Justice Douglas says in the principal case that the rights of the secured creditors were protected by the Act ". . . to the extent of the value of the property. There is no constitutional claim of the creditor to more than that." Again he said, referring to the *Vinton* case, "In that case this Court, in sustaining the constitutionality of sec. 75(s)(3), emphasized that the Act preserved the right of the mortgagee to realize upon the security by a judicial sale. By our construction the exercise of this right is merely deferred or postponed until the other conditions and requirements of the Act, prescribed for the protection of the debtor, have been met. It is eventually denied the creditor only in case he is paid the full amount of what he can constitutionally claim." From these statements it seems clear that the right of the mortgagee has been materially reduced to something less than the absolute right to a public sale, with a corresponding increase in the right of the mortgagor—farmer.

It is not with complete assurance that one can state the effect of the principal case upon the *Radford* and *Vinton* cases because in the *Vinton* case it was stated that sec. (s) of the first Frazier-Lemke Act was unconstitutional, not because any one of the five enumerated rights had been taken away, but because the impairment of all five violated the due process clause.<sup>17</sup> But in addition Justice Brandeis said without qualification that under the second Frazier-Lemke Act the mortgagee had a right of sale.<sup>18</sup> This right and an opportunity to bid at such sale would seem to be the crux of the matter, since without these the rights of which the *Vinton* case speaks become a shell. On this hypothesis the conclusion seems inevitable that here we have in effect a silent reversal of the *Radford* case and an equally silent rejection of the reasoning in the *Vinton* case.

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<sup>16</sup> The bill as originally reported out of committee, S 3002, Sen. Report No. 985, 74th Cong., 1st Sess. The debate revealing the reason for the deletion will be found in 79 Cong. Rec. 13633.

<sup>17</sup> *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, Va., et.al.*, 300 U.S. 440 (457), 57 Sup. Ct. 556 (559), 81 L.Ed. 736 (740) (1937).

<sup>18</sup> *Wright v. Vinton Branch of Mountain Trust Bank of Roanoke, Va. et.al.*, 300 U.S. 440, 457, 57 Sup. Ct. 556, 559, 81 L.Ed. 736, 740 (1937).